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IN THE

Supreme Court of the United States

October Term, 1973

No. 73-1249

THE JOHNS HOPKINS UNIVERSITY,
Cross-Petitioner,

against

WILLIAM E. HUTTON, *et al.*,
Cross-Respondents.

ON CROSS-PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

BRIEF FOR CROSS-RESPONDENTS, HUTTON, IN OPPOSITION TO THE CROSS-PETITION OF THE JOHNS HOPKINS UNIVERSITY

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In The

Supreme Court of the United States

October Term, 1973

No. 73-1249

The Johns Hopkins University,
Cross-Petitioner,

against

William E. Hutton, et al.,
Cross-Respondents.

On Cross-Petition For Writ of Certiorari to the United States Court of Appeals For the Fourth Circuit

BRIEF FOR CROSS-RESPONDENTS, HUTTON, IN OPPOSITION TO THE CROSS-PETITION OF THE JOHNS HOPKINS UNIVERSITY

On January 30, 1974, the Cross-Respondents herein ("Hutton") filed a Petition (No. 73-1166) for a writ of certiorari to review the judgment and opinion of the Fourth Circuit, entered December 4, 1973 under § 10(b) of the Securities Exchange Act of 1934 and § 17(a) of the Securities Act of 1933. Hutton's Petition concerned certain elements required, under the circumstances of this case, to found *liability,* viz: reliance and the reasonableness of Hopkins' reliance, and Hopkins' diligence in discovering the alleged misstatements of Hutton. Thereafter, on February 12, 1974, the Cross-Petitioners ("Hopkins") filed a Petition to review the same judgment and opinion, but its Petition concerns only the *remedy* of rescission.

The Questions on Hopkins' Cross-Petition as Presented By Hutton

In Hutton's Petition we have set forth at length the proceedings below and the pertinent facts. These facts are necessary also to an adequate understanding of Hutton's opposition to Hopkins' Cross-Petition. To avoid needless repetition we respectfully refer the Court to that detailed statement of facts. In this brief Hutton will set forth the QUESTIONS PRESENTED on Hopkins' Cross-Petition as Hutton believes they should be stated. But first we point out that Hopkins' statement of its QUESTIONS is premised upon certain unfounded assumptions and arguments. For:

1. Hopkins asserts throughout that it has been held barred from rescission on the ground of "unilateral waiver" (pp. 4, 12-25). Thus, it injects a phantom issue. In fact, Hutton pleaded as defenses to Hopkins' rescission claim under §§ 10(b) and 17(a): that Hopkins was barred by its failure "to act with reasonable diligence" after receiving notice of the alleged misstatements; that Hopkins was barred by "laches" because it "delayed unreasonably in asserting rescission" after Hopkins "knew or should have known" of the alleged misstatements; and that Hutton was "*prejudiced by this delay.*"*

Moreover, the Court of Appeals never mentioned or discussed "waiver," whether "intentional," "unilateral," or otherwise. Instead, the Court expressly held that Hopkins is not entitled to summary judgment of rescission under the traditional federal equity doctrine which requires a plaintiff to act with reasonable dispatch after knowledge or notice of material facts.

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* On January 7, 1972 the District Court granted Hopkins' motion to amend its Amended Complaint, to assert for the first time under Counts II, III & V a claim for rescission under §§ 10(b) and 17(a). On January 10, 1972 the District Court allowed Hutton to plead the above defenses by amendment to its Answer.

2. Hopkins further asserts that "Hutton were not prejudiced by any lateness in Hopkins' demand by any changes in the security since its purchase" (p. 4). But the evidence is uncontradicted that drastic changes in the nature of its production payment and vast losses of assets occurred during the years of Hopkins' inaction and delay.

Up to the present, more than ten years has elapsed since the purchase of the production payment on March 1, 1961. Hopkins in its Complaint filed November 1, 1963, sought rescission and return of the purchase price only under Count I, § (12(2); and *damages only* under Counts II, III and V, §§ 10(b) and 17(a). Not until after the Court of Appeals had held on February 18, 1970, on the first appeal, that Hopkins was *not* entitled to summary judgment under § 12(2), did Hopkins inform the District Court that it had decided—some seven years after commencing the action—to seek rescission under Counts II, III, and V, §§ 10(b) and 17(a).

3. Hopkins also asserts that it had no "actual", or "imputed", or "constructive knowledge" of Hutton's "frauds" (p. 4). But, the Court of Appeals on the first appeal involving Count I and § 12(2), had found that Hopkins, more than one year before it brought suit on November 1, 1963, had actual knowledge of some of the misstatements charged by it and could readily have discovered all of the alleged misstatements about which it now complains. (422 F. 2d 1124, 1129, 1131; App. E-8, 11, 12).

4. Hopkins further accuses Hutton of "fraud" (p. 4). In fact, the District Court twice refused to rule that Hutton's employee who made the alleged misstatements, "was guilty of fraud in the common law sense" or that he "acted as an evil man." 297 F. Supp. at 1219, 1220 (App. F-104, 105, 107) and 326 F. Supp. at 255 (App. B-8). And the Court of Appeals found also that "the Hutton partners were personally blameless." 422 F. 2d at 1130 (App. E-9).

Hutton will now state the Questions on Hopkins' Cross-Petition as it believes they should properly be presented:

1. Did not the Court of Appeals properly hold that Hopkins is not entitled to summary judgment of rescission under §§ 10(b) and 17(a), because Hopkins had delayed unreasonably in asserting rescission for several years: after it had gained such knowledge, information and notice as would have led a reasonable investor to discover any misstatements; after it had in fact *actually* learned of certain important facts allegedly misstated; and after it had also been given ready access to *all* the pertinent facts.

2. Does not the Court of Appeals' ruling on the first appeal that Hopkins is not entitled to summary judgment of rescission under Count I, § 12(2) also preclude Hopkins from obtaining summary judgment of rescission under §§ 10(b) and 17(a), since the Court of Appeals *then held* that Hopkins had actual knowledge of certain misstatements and could readily have discovered every alleged misstatement prior to November 1, 1962, that is, more than one year before the commencement of the action on November 1, 1963.

3. Did not Hopkins lose its right to rescind because it failed for a period of years to use due diligence in asserting its rights under §§ 10(b) and 17(a), and because during its inexcusable delay, drastic changes and vast loss and waste of assets had occurred, resulting in a production payment greatly depleted in value.

4. Does not Hopkins have the burden of proof under the traditional equity doctrine to show that it sought rescission with reasonable dispatch after knowledge or notice of material facts. But notwithstanding burden of proof, does not the evidence establish overwhelmingly and without contradiction, that Hopkins lost the power to rescind because it delayed unreasonably after having received abundant knowledge and notice of material facts.

5. Did not the Court of Appeals properly reverse the grant of summary judgment of rescission to Hopkins, be-

cause at the very least there are genuine issues of material fact for trial by jury concerning: whether Hopkins lost the right to rescind by failing to assert rescission with reasonable promptness after having "inquiry-notice", that is to say after learning material facts which charged it with such knowledge and notice of alleged wrongdoing as reasonable inquiry would have revealed.*

Statement Of The Case

Hopkins bought the production payment on March 1, 1961 not as "the result of long, urgent solicitations by Hutton," as Hopkins asserts (p. 7) but rather upon the recommendation of Hopkins' legal and investment advisers after seven months of face-to-face negotiations between Hopkins and Trice, the seller. Naess, the senior partner of Naess & Thomas, investment counsel to Hopkins for over 20 years, "introduced" Trice to Baker, the Treasurer of Hopkins. Trice had offered to pay Naess, his friend since 1957, a "2% finder's fee" for monies invested by clients of Naess in Trice production payments. Naess was deeply involved in the purchase and strongly recommended it to Hopkins.

Hopkins learned further facts, wholly ignored by Hopkins, after March 1, 1961 putting it on inquiry notice

For the months of March and April 1961, Trice's payments to Hopkins were $4,041.95 less than the 6% interest which Trice had guaranteed. On August 3, 1961, the $4,041.95 was "still due." Similarly, for the months of May, June, August and December 1961, Trice's payments were less than the 6% interest guaranteed by Trice. In April 1961, the Dollar well was plugged and abandoned, and throughout 1961, Trice failed to remit to Hopkins any proceeds from Pone Gas Unit No. 1. Hopkins never received

* Hereinafter the term "inquiry-notice" will sometimes be used as a convenient shorthand method for referring to: knowledge or notice of facts or information, which would have led a reasonable investor to investigate and which would have led him to discover facts allegedly misstated or omitted or other wrongdoing.

any payments for the month of December 1961 from the Hughes well. Moreover, on December 31, 1961, Hopkins was roughly 70% off target as to the principal specified for payment in the September 16, 1960 Trice brochure.

In January 1962, Hopkins knew that several wells were not producing or were underproducing

In January 1962, Baker, Treasurer of Hopkins, learned: that the reserves for the MacDonald well, i.e. *one-third of all reserves* in the production payment, were not as high as had been estimated by outside consultants; that of the 23 wells, "three or more had not been producing" and an "additional six wells were under or non-producing"; that payments to Bankers Trust, which had a primary position in 18 of the 23 wells in the production payment, were behind schedule; that there had been underproduction on the forecast and that payments to Bankers Trust had been $125,000 under the estimate; and that repayments of principal and interest would be delayed by six months. On January 25, 1962, Baker became "uneasy" about the production payment, and requested that Naess investigate whether Brown, Hopkins' own oil and gas consultant, was reliable in his estimates.

Hopkins knew early in 1962 that Trice was "in the red"—on the verge of bankruptcy

In January and February 1962, Baker, Naess, Canedy, and the Hopkins Finance Committee were fully aware that Trice's current position was "in the red" and that Trice was close to bankruptcy. Hopkins had known since September 1960 that Trice had a serious deficiency in cash and working capital which it needed as owner-operator of the wells.

On February 12, 1962, Hopkins received from Dun & Bradstreet its report containing the Trice balance sheet stating $3,128,761 current assets and $20,936,181 current liabilities, an adverse ratio of nearly 7-to-1. This showed glaring discrepancies in Trice's financial representations.

For, only six days earlier on February 6, Trice had furnished Baker a Trice balance sheet stating $3,153,967 current assets and only $7,669,184 current liabilities. On February 13, 1962, Baker outlined to Naess the Trice balance sheet in the D&B report and the conflicting representation in the Trice balance sheet. But this had no deterrent effect.

Further delayed payments; bouncing checks; commingled funds

In May, June and July, 1962 Baker, Naess, Canedy, Dandridge, a partner in Venable Baetjer, and the Hopkins Finance Committee knew that Trice's payments under the production payment were delayed and behind schedule. In May and June, 1962, Hopkins received two Trice checks aggregating over $24,000 which "bounced" twice. And in June and July, 1962 Baker, Dandridge, and the Committee learned that Trice had *dishonestly commingled* Hopkins' funds and used them for its own purposes. Moreover, at a meeting held on July 3, 1962 with Baker and Dandridge, Berman of Hutton: expressed concern about Trice's financial condition; stated that Trice had commingled funds owing to others than Hopkins; and suggested to Baker and Dandridge that Hopkins "should look into its position with Trice" and do what was necessary to protect its interests.

In July 1962, the Finance Committee confronted Trice with the commingling and the bouncing checks and Hopkins itself took steps to segregate its funds from the funds of Trice. Trice's payments to Hopkins were $7,000 less than guaranteed for July and August of 1962. And in August 1962, Dandridge was again warned that he should watch the Trice situation carefully.

In September 1962, Hopkins distrusts the estimates of production; and the Trice debacle ends in bankruptcy

Up to September 1962, Hopkins had received no revenue at all from the Pone Well and on September 7, Berman reported to Baker that an attorney for Trice participants said there was "enough to put Trice in jail." Later in

September, Hopkins voiced "concern" to its consultant Brown that the wells "were not performing" as anticipated; and Hopkins' Assistant Treasurer asked Brown "how far 'off the target' " Hopkins was "from the amortization schedule" Brown had "originally forecast." Also during this month Baker inquired whether the payments in reduction of principal equalled the estimate Brown had made. On October 15, 1962, *Trice went bankrupt*—more than one year before Hopkins commenced this action on November 1, 1963. The bankruptcy was sufficient in itself to put Hopkins under a duty of immediate and exhaustive inquiry.

Not surprisingly the Fourth Circuit concluded when it ruled that Hopkins is not entitled to a summary judgment of rescission under § 12(2), that (422 F. 2d at 1130; App. E-11):

> "But surely the failure of some wells to produce as scheduled coupled with Trice's lack of candor about its finances might cause a reasonably diligent investor to probe the data upon which he based his purchase. *Had Hopkins compared all the experts' reports, which it had a right to do under the terms of the production payment, it could readily have discovered the untrue statements and the omissions about which it now complains.*"

Hopkins, however, failed to bring suit until November 1, 1963, almost three years after it had first learned of certain basic misstatements, and without ever obtaining the readily available data which would have disclosed every pertinent fact.

During 1960, 1961, and 1962, there were drastic changes in the production payment and great losses of assets therefrom

During the period of delay and inaction by Hopkins—1960, 1961 and 1962 there occurred: (a) loss and waste of assets ranging from $1,600,000 to $2,660,000, caused, in the main, by Hopkins' own acts and omissions which greatly

depleted the value of the production payment; and (b) drastic changes in the well ownership interests, as set forth below:

> (i) Unitization of the wells caused a vast reduction in the underlying reserves owned by Hopkins. The Nunez unitization was the "important reason" for a "drastic $1,166,000 loss of reserves"; and after unitization of Nunez, Hopkins "ended up with less dollars" for the future.
>
> (ii) Faulty operation of certain wells caused heavy losses of reserves: $630,000 from the Hester well; $332,000 from the Woodworth well; $352,000 from the MacDonald well; and $76,000 from the Weatherford well—a total of $1,390,000, or more than Hopkins paid for the production payment.
>
> (iii) Hopkins modified, by agreement, the production payment, resulting in a reduction of reserves securing the payment. And certain wells in the production payment were abandoned entirely;
>
> (iv) Hopkins agreed to the unitization of its interests in several wells, with interests in other wells not in the production payment. So that Hopkins finally had a vastly smaller interest in 110 wells, as against its initial interest in 23 wells.

Thus, the production payment which Hopkins now seeks to hand back to Hutton is a vastly depleted production payment.

The Court of Appeals properly reversed the summary judgment of rescission for Hopkins, stating that (App. A-11):

> "Finding summary judgment inappropriate on this issue of Hopkins' promptitude, we reverse the decree of the district court in that respect and remand for a jury trial upon the issue of whether Hopkins demanded rescission within a reasonable time after it had actual

knowledge of the grounds for rescission or notice of facts which, in the exercise of due diligence would have led to actual knowledge of such grounds."

This standard fairly takes into account the knowledge which Hopkins actually had. And it gives effect to the further knowledge a reasonable investor would have had under the circumstances here presented. Also it is in accord with the traditional equity doctrine which the federal courts have applied for years.

ARGUMENT

I

The authorities fully support the Court of Appeals' decision that Hopkins, to obtain rescission was required to act with reasonable dispatch.

The Court of Appeals applied the traditional equity doctrine that wrongdoing is "discovered" not only when the plaintiff has full knowledge thereof but also when he has knowledge of such facts and information as would lead a reasonable man to inquire and to obtain complete knowledge. It cited *Holmberg* v. *Armbrecht,* 327 U.S. 392, 397 (1946); *Bailey* v. *Glover,* 88 U.S. 342, 348 (1874); and *Wood* v. *Carpenter,* 101 U.S. 135 (1879). Mr. Justice Swayne who, one year earlier, had written the opinion in *Pence* v. *Langdon,* now relied on by Hopkins, discusses, in *Wood* v. *Carpenter* the effect of "notice" on a plaintiff suing for fraud and the burden of proof which that requires (p. 141, 143):

> " 'Whatever is notice enough to excite attention and put the party on his guard and call for inquiry, is notice of everything to which such inquiry might have led. *When a person has sufficient information to lead him to a fact, he shall be deemed conversant of it*' . . . 'The presumption is that if the party affected by any fraudulent transaction or management might with ordinary care and attention, have seasonably detected it, he seasonably had actual knowledge of it' . . .

> *"A party seeking to avoid the bar of the statute on account of fraud must aver and show that he used due diligence to detect it and if he had the means of discovery in his power, he will be held to have known it."*
>
> *"There must be reasonable diligence; and the means of knowledge are the same thing in effect as knowledge itself."* .
>
> "The circumstances of the discovery must be fully stated and proved, and the delay which has occurred must be shown to be consistent with the requisite diligence."*

And, even earlier, this Court in *Badger* v. *Badger,* 2 Wall. 87 (1864), affirming the dismissal of a bill in equity which sought on grounds of fraud to set aside a title obtained by judicial sale, had pointed out the necessity of inquiry by a plaintiff, saying (p. 95);

> ". . . It is true, there is a general allegation, that the 'fraudulent acts were unknown to complainant till within five years past,' while the statement of his case shows clearly that he must have known, *or could have known, if he had chosen to inquire at any time in the last thirty years of his life, every fact alleged in his bill."*

This doctrine requiring that rescission be sought with reasonable promptness after knowledge or notice of material facts, has been recognized also in numerous later decisions. See: *Goldenberg* v. *Bache & Co.,* 270 F. 2d 675, 681 (5th Cir. 1959); *Azalea Meats, Inc.* v. *Muscat,* 386 F. 2d 5, 8 (5th Cir. 1967), *Baumel* v. *Rosen,* 412 F. 2d 571 (4th Cir. 1969) *cert. den.* 396 U.S. 1037); *Tobacco and Allied Stocks* v. *Transamerica Corp.,* 143 F. Supp. 323, 331 (D. Del. 1956) *aff'd* 244 F. 2d 902 (3rd Cir. 1957); 3 *Pomeroy's Equity Jurisprudence* (5th Ed. 1941) § 917; Friedman, *Delay As A Bar To Rescission,* 26 Cornell Law Quarterly,

* Emphasis added throughout.

426, 432 (April 1941) and the cases cited therein; 37 *Am. Jur. 2d, Fraud and Deceit,* §§ 408, 410, 444 (1968) and 27 *Am. Jur. 2d, Equity,* §§ 162, 167 (1966). See also *McLean* v. *Clapp,* 141 U.S. 429, 432 (1891); *Twin-Lick Oil Co.* v. *Marbury* 91 U.S. 587, 592-593 (1875).

As the Court of Appeals in *Baumel* v. *Rosen, supra* (cert. denied), relied on by the Court of Appeals in the present case, said (412 F. 2d at 574):

> "Rescission is a radical move, and the law exacts the election of that course to be asserted without wait. The demand is that advice of the determination be given within a reasonable time after discovery of the ground for rescission.
>
> This principle is stringently administered. *Reasonable time is inceptive from the receipt by the rescinder of word putting him on notice. It is then incumbent upon him to pick up the scent and nose to the source.* ***(citation omitted). If the quest confirms the suspicion, then he must make decision with reasonable dispatch. Failing this, entitlement to rescission disappears."*

Also, as the Court of Appeals properly held, the burden is on the plaintiff, Hopkins, to prove that it sought rescission promptly. See Friedman, *Delay As A Bar To Rescis-*

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* Hopkins' counsel, Venable, Baetjer represented the defendant, Rosen, against whom recission had been asserted in *Baumel.* Venable, Baetjer there argued that § 13 of the 1933 Act, the one year limitations provision, is "consistent with" the "traditional equity doctrine" that "date of discovery" includes the date "on which, in the exercise of reasonable diligence, the plaintiff should have made discovery." (p. 62 of Venable, Baetjer's Brief in *Baumel* v. *Rosen,* 412 F. 2d 571 (4th Cir. 1969)). With those statements Hutton agrees. For Congress having *codified* the already existing common law of rescission in § 12(2), accordingly *codified* in § 13, as well, the already existing common law of inquiry-notice, with a one year limitation provision. The federal courts have also, despite the existence of § 12(2), adapted and implied a private cause of action under § 10(b), which of rational necessity includes not only the common law right to rescind but also the related common law doctrine of inquiry-notice which limits that right—contrary to Hopkins' assertions at p. 18.

sion, Cornell Law Quarterly, Vol. 26 at 428, 452 (1941), cited by the Fourth Circuit in its opinion of December 4, 1973 (n. 12 at App. A-6-7). And see also, 2 Black, *Rescission And Cancellation*, §§ 536, 541-48 (2d ed. 1929); 37 Am. Jur. 2nd *Fraud And Deceit*, § 417 (1968); 3 Pomeroy, *Equity Jurisprudence*, § 817 (5th ed. 1941); the cases cited in these treatises and also by Friedman; and *Wood* v. *Carpenter*, 101 U.S. 135, 140, 141 (1879).

As the Fourth Circuit said in its opinion of December 4, 1973 (n. 12 at App. A-7), "The basis for placing this burden upon the rescinder . . . stems from the drastic nature of the relief sought by the plaintiff . . ."* But, in the circumstances of this case it is not necessary to consider any technical questions of the shifting burdens of proof, such as Hopkins would now raise (pp. 22-23). For, Hutton has adduced overwhelming evidence which establishes beyond doubt that Hopkins delayed for many years, to Hutton's vast prejudice, although Hopkins had knowledge and notice of abundant material facts putting it on inquiry.

Summary judgment in favor of Hutton on the issue of rescission would, we submit, be warranted but at the very least a question for trial by jury is presented under both § 12(2) and § 10(b).

II

The Court of Appeals' decision with respect to Hopkins' right to rescind does not conflict with this court's decision in *Pence* v. *Langdon* or with any other decision of this court.

Pence v. *Langdon*, 99 U.S. 578 (1878) discussed by Hopkins at pp. 12-14 is an action at law in which this Court reviewed a trial court's instructions to a jury which had

* Also, Hopkins' counsel Venable, Baetjer, at p. 68 of their Brief in *Baumel* reviewed the authorities and stated that ". . . the burden is on he who seeks to rescind [Hopkins in the present case] to prove that he acted promptly; that "unreasonable delay in electing to rescind bars the right to rescind"; and that ". . . the delay fatal to rescission is often held to be but a few weeks or months . . ." With these statements also, Hutton agrees.

found that plaintiff was entitled to rescission. Plaintiff had demanded rescission *one day* after he learned of certain misstatements of defendant. This Court found that there was "no proof that he [plaintiff] had the slightest knowledge or even *suspicion* of any foul play". These facts are far different from those in the *Hopkins* case. But, the Court expressly pointed out that a person seeking rescission (p. 581):

> ". . . *may not wilfully shut his eyes to what he might readily and ought to have known.* When fully advised he must decide and act with reasonable dispatch. He *cannot rest until the rights of third persons are involved and the situation of the wrong-doer is materially changed.* Under such circumstances he loses the right to rescind, and must seek compensation in damages."

Here, Hopkins had actual knowledge of highly significant misstatements, but, it "shut its eyes" to what it "might readily and ought to have known". So found the Fourth Circuit, on the first appeal, when it held that Hopkins was not entitled to summary judgment of rescission under Count I § 12(2), saying (422 F. 2d 1124, 1129, 1131 (App. E-8, 11):

> "Shortly before the purchase of the production payment [on March 1, 1961], Trice furnished information which disclosed that the estimates for thirteen wells came from sources other than D&M [Degolyer & MacNaughton]. *To this extent, the information revealed [to Hopkins] LaPiere's misstatements about the identity of the estimators.*"
>
> • • •
>
> "*Before November 1, 1962* Hopkins learned that Trice was in financial trouble, that some of its checks were returned for insufficient funds, that Trice's report of its financial condition could not be reconciled with Dun & Bradstreet's, that the return from another production payment [Bankers Trust] was behind schedule, that

some of the wells underlying Hopkins' payment were not producing or were underproducing, and that an involuntary petition for bankrupcty had been filed against Trice."

• • •

". . . But surely the failure of some wells to produce as scheduled coupled with *Trice's lack of candor about its finances might cause a reasonably diligent investor to probe the data upon which he based his purchase.* Had Hopkins compared all the experts' reports, which it had a right to do under the terms of the production payment [prior to purchase], *it could readily have discovered the untrue statements and the omissions, about which it now complains."*

Hopkins' inexcusable disregard of important facts which it did know and inexcusable ignorance of other facts which it could readily have found out is also clearly apparent from the events of the significant meeting of February 7, 1961, almost a month before the purchase, at the offices of Venable, Baetjer.* That meeting was not attended by LaPiere or by any other representative of Hutton. Mitchell of Trice offered to provide to Baker and Dandridge "any information" required. But Baker never asked for or obtained the experts' reports which contained information with respect to the reserves radically different from that in the original September 16, 1960 Trice brochure. Instead, Hopkins and its own legal and financial advisors had obviously decided to "go it alone." They had determined to rely wholly, as they did thereafter: (a) upon a new and drastically different superseding Trice brochure of February 3, 1961, never seen by Hutton and for which it had no responsibility; (b) upon the Trice special financial guarantee of February 23, 1961, also never seen by Hutton as to which the Court of Appeals expressly held: "Hopkins

* For details of this meeting see Hutton's Petition For Certiorari at p. 11.

would not have purchased the production payment without Trice's guarantee"; and (c) upon such inexcusably meager information as Hopkins and its own advisors themselves chose to regard as satisfactory.

Clearly the action of the Fourth Circuit, in reversing summary judgment of rescission in favor of Hopkins is entirely in accord with *Pence* in the light of what Hopkins actually knew and what it might readily have known.

Vast losses and drastic changes in the nature of the production payment occurred during Hopkins' delay

Highly significant also is the fact that during the period of Hopkins' delay and inaction—1960, 1961 and 1962: (a) there were vast losses and waste of assets of some several million dollars which greatly depleted the value of the production payment; and (b) there were, also, drastic changes in the ownership interests purchased by Hopkins. But, despite the vast drop in value of the production payment Hopkins failed to assert its claim for rescission promptly. This made the basic objective of rescission impossible—namely, the return of the parties to *status quo ante*. Instead, in the words of *Pence:* Hopkins "rested" until the rights of third persons became involved and the "situation" of Hutton "materially changed". Thus, under the decision in *Pence* also Hopkins has lost its right to rescind.

III

Nor is the decision of the Court of Appeals in conflict with decisions of other Courts of Appeals, including the *Royal Air Properties* cases.

Royal Air Properties, Inc. v. *Smith,* 312 F. 2d 210 (9th Cir. 1962) (first appeal), cited by Hopkins (p. 15), merely holds at p. 214 that since the right of action created for violation of § 10(b) may be enforced at law or in equity, it is "subject to the doctrine of laches as well as the statute of limitations". But this is not here at issue. *Royal Air*

Properties, Inc. v. *Smith,* 333 F. 2d 568 (9th Cir. 1964) (second appeal) is cited by Hopkins principally for the Court's views concerning "waiver" as a defense (pp. 15-17). But, as already noted (p. 2), the Fourth Circuit does not even mention the term "waiver" in either of its opinions. See the defenses as actually pleaded by Hutton (p. 2 *supra*). The Fourth Circuit on the second appeal expressly applied the common law rule that prompt action after knowledge or notice of material facts, is an element of the rescinder's cause of action. See Friedman, *Delay As A Bar To Rescission,* 26 Cornell Law Quarterly at 428, 452 (1941) (App. A-6, A-7). Obviously misplaced is Hopkins' reliance on *Royal Air Properties.*

Moreover, the facts in *Royal Air Properties* clearly distinguish that case from the *Hopkins* case. There, the plaintiff was a doctor "exceedingly gullible", "divorced" from the business world. (333 F. 2d at 572) He had no knowledge of the alleged misstatements made to him. Hopkins, on the other hand, was an experienced and knowledgable investor advised by an eminent Finance Committee, and by legal and investment counsel. It had actual knowledge of glaring misstatements, several years before it took action. These facts in themselves distinguish the *Hopkins* case.

Significant, also, is the fact that the Court in *Royal Air Properties,* in excusing the plaintiff's lack of diligence, held that the delay had not prejudiced the defendant. But it did point out that a lack of diligence will bar a claim for return of the purchase price under § 10(b) when the delay "... has resulted in a disadvantage" to the party [Hutton] against whom rescission is asserted. 333 F. 2d at 570.*

There would obviously be "disadvantage" and vast prejudice to Hutton, if it should be required at this late date to return to Hopkins the purchase price in exchange for the production payment, now massively depleted in value

* See Hutton's affirmative defenses, set forth *supra,* p. 2.

due to Hopkins' delay and acts of omission and commission. The Fourth Circuit's decision does not conflict in any way with *Royal Air Properties, Inc.* v. *Smith.*

IV

The decision of the Court of Appeals is also in accord with basic principles of law and the remedial purposes of the federal securities laws.

Hopkins at pp. 15-25 argues that "the *all-pervading* reason for granting the writ is because of . . . confusion and adverse effect" arising from the Fourth Circuit's "errors". But the Fourth Circuit's decision is both an appropriate and a consistent application of the equitable principle requiring that equitable rights be asserted with reasonable promptness. It results in no "confusion" and Hopkins has shown none.

The cases cited by the Court of Appeals which Hopkins seeks to distinguish at p. 20, uniformly hold that a plaintiff is time-barred if he delays in *bringing suit* when he knew or ought to have known of alleged wrongdoing. This is wholly consistent with the ruling in *Pence* v. *Langdon* that a plaintiff "loses his right to rescind" where he "shuts his eyes" to the facts which "he might readily and ought to have known." In each case, the principle is the same. And the application is especially appropriate to the right of rescission because of the drastic nature of the remedy.

Hopkins ignores the basic equitable principle of reasonable promptitude, when it asserts with an implication of finality (p. 22) that it brought suit within the three year Maryland statute of limitations. For that principle operates independently of the statute of limitations. See: *Halstead* v. *Grinnan,* 152 U.S. 412, 416-417 (1893); *Twin-Lick Oil Co.* v. *Marbury,* 91 U.S. 587, 591 (1875); *Royal Air Properties, Inc.* v. *Smith,* 312 F. 2d 210, 214 (9th Cir. 1962).

Also, Hopkins attempts at pp. 23-25 to distinguish *Baumel* v. *Rosen*, 412 F. 2d 571 (4th Cir. 1969) *cert. den.* 396 U.S. 1937 (1970). In that case, the Court of Appeals held the plaintiffs barred from rescission under § 10(b), although they had brought suit within the three year Maryland statute of limitations. Hopkins asserts (p. 24) that "Baumel's conscious inequitable conduct justified the Fourth Circuit's decision that it constituted the defense of waiver..." But in fact the Court did *not* hold that plaintiffs were aware of or "conscious" of the wrongdoing and it did not hold them barred by "waiver." What the Court did hold was: that more than three years before bringing action, the plaintiffs had (412 F. 2d at 574), "*wind* of the malodor" —not actual knowledge of the cause of the "malodor"; and that accordingly, under the common law of rescission, it was then "incumbent upon [plaintiffs] to pick up the scent and *nose to the source*"—that is, to the defendant's misstatements of financial condition.

Hopkins also erroneously asserts (p. 24) that the plaintiff Baumel had "full and complete knowledge of the fraud" for a period of 18 months before asserting rescission. But the Court on the contrary only found that plaintiffs were then (412 F. 2d at 574, 576) "... *chargeable with* complete awareness of the knavery" because they then "... knew *or should have known*" of their "dupery."

Hopkins, however, had actual *knowledge* of certain basic misstatements, among other things, and yet "deliberately shut [its] eyes to obvious facts" which clearly pointed to other misstatements and to wrong-doing, and yet it decided to "go it alone" and make the purchase.

Contrary to Hopkins' argument at pp. 19-20, the Fourth Circuit's rulings have not penalized an "innocent purchaser of a security." Nor would its rulings force a "waiver" upon Hopkins. On the contrary, the principle applied by the Fourth Circuit fairly holds that Hopkins with knowledge and sufficient information to take effective action, could not

thereafter delay unreasonably in asserting the drastic remedy of rescission. And, this principle is especially just in its application, where, as here, massive prejudice and loss have resulted to Hutton from Hopkins' delay and inaction.

Conclusion

For the foregoing reasons, Hopkins' Cross-Petition to review the judgment and opinion of the Fourth Circuit, should be denied.

Respectfully submitted,

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March 13, 1974

Certificate of Service

I hereby certify that on March 13, 1974, I served upon Respondent three copies of the foregoing Brief For Cross-Respondents, Hutton, In Opposition To The Cross-Petition Of The Johns Hopkins University by depositing said copies in a United States post office, with first class postage prepaid, addressed to Respondent's attorneys of record at their post office address:

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I further certify that all parties required to be served have been served.

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